

**IN THE MATTER OF THE APPLICATION REGARDING CONVERSION
OF PREMIERA BLUE CROSS AND ITS AFFILIATES**

Washington State Insurance Commissioner's Docket # G02-45

PRE-FILED DIRECT TESTIMONY OF:

Heyward Donigan

Executive Vice President and Chief Marketing Officer
Premiera Blue Cross

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Introduction

Q. Please state your name.

A. Heyward Donigan.

Q. Please state your employer, title, and business address.

A. I currently serve as Executive Vice President and Chief Marketing Executive for
Premera Blue Cross (“Premera” or the “Company”). Premera is located at 7001 220th
Street SW, Mountlake Terrace, Washington.

Purpose and Conclusions of Testimony

Q. What is the purpose of your testimony?

A. My testimony describes the competitive environment in which Premera does
business in the state of Washington. It focuses on (1) Premera’s significant for-profit and
not-for-profit competitors in the state; (2) the feasibility of new entry, that is the extent to
which some who might not now compete with Premera in a product line or service area
could do so; and (3) the effects of competition that drive, and will continue to drive,
pricing and service in the state regardless of whether or not Premera becomes a for-profit
company.

Q. What are the primary conclusions to be drawn from your testimony?

A. The health insurance market in Washington is very competitive. Many for-profit
and not-for-profit companies currently serve the state, and to the extent that some might
not now compete with Premera in a product line or service area, they could easily do so.
New entry is also feasible. Competition drives pricing and service in the state, and that
will continue to be true whether or not Premera becomes a for-profit company.

Credentials

Q. Please describe your professional training and experience.

A. I have served as the Executive Vice President and Chief Marketing Executive for Premiera Blue Cross since April 2003. In this role, I lead the sales, marketing, and product development efforts for all Premiera companies.

I have over 20 years of experience in the health insurance industry, working for both non-profit and for-profit health plans. Prior to coming to Premiera, I was employed at Cigna Healthcare, where I most recently held the position of Senior Vice President for Service Operations. Prior to that position, I served as Senior Vice President of Transformation. In this role, I directed the company's transformation project to develop new products, reengineer business processes and develop and enhance systems. Also while at Cigna, I served as President of the Southeast region and General Manager of the Georgia/Alabama markets.

Before joining Cigna, I served as Senior Vice President, Managed Care and Sales for Empire Blue Cross and Blue Shield, a New York Blue plan. Prior to this role, I served in a variety of leadership positions with a number of health insurance companies across many disciplines, including operations, sales, marketing, network management and contracting, and product development.

Q. Please describe your educational background.

A. I received a Bachelors of Arts degree in English from the University of Virginia in 1983 and a Masters of Public Administration in Health Care Finance from New York University in 1992.

Premera's Competitors

Q. What companies does Premera compete with in Washington?

A. Premera competes for business against a wide variety of companies, including other health plans and third party administrators. Premera's competitors are organized as both for-profit and non-profit companies.

For commercial products, the Company's primary competitors are the Regence Group ("Regence"), Group Health Cooperative ("Group Health"), and some of the largest publicly traded health plans such as CIGNA, Aetna, and PacifiCare.

In addition, Premera faces a unique competitive situation in that it competes directly with another Blue licensee, something that only occurs in a few places throughout the country. Regence Blue Shield and Premera Blue Cross both offer Blue-branded products in Western Washington, thereby increasing the competitive nature of the marketplace.

For government-sponsored business, Premera also competes with Regence, Group Health and national commercial carriers, plus companies that focus specifically on government-sponsored business such as Community Health Plan and Molina Healthcare, Inc.

In addition to competing for fully-insured health care coverage, Regence, Group Health and national carriers offer self-insured products. Premera also faces competition from third party administrators for this business. Because of potential cost savings, larger groups in the mid-market segment often consider the option of self-insuring. When self-insuring, the employer group assumes the insurance risk and contracts with a health plan or third party administrator to provide the necessary administrative services for their

1 group. While companies are not required to report this membership to the OIC, Premera
2 has estimated that approximately 25% of all group insured members (roughly 850,000
3 members in Washington) receive coverage through a self-insured plan.

4 **Participation in Products and Service Areas**

5 **Q. How does Premera decide to participate in a particular product line?**

6 A. Premera reviews each of its product lines regularly to assess whether Premera has
7 the products and services to serve consumers well and profitably. This is done by
8 analyzing sales results, broker feedback, the competitive environment, medical trends,
9 program or product line requirements (e.g. degree of managed care activities), effect on
10 providers and short and long-term profit potential. If the analysis concludes that the
11 market does not favor a particular product and the longer-term profit potential is
12 problematic, Premera would consider stopping the sale of that product. Before doing so,
13 Premera weighs any potential ramifications that may accompany a cessation of sales,
14 such as regulations limiting re-entry, the cost of exit, and potential impact on other lines
15 of business.

16 **Q. Has Premera stopped sale of any lines of business, or curtailed its
17 participation, in the past? If so, why?**

18 A. On several occasions in the past five years Premera has curtailed participation in
19 various lines of business. In 1998, Premera stopped offering new individual policies
20 after suffering significant losses in that business. Also in 1998, Premera discontinued
21 offering Basic Health Plan and Healthy Options in certain counties when it found it could
22 not generate a profit in those counties at the premium rate the state was offering to pay.
23 Like many health plans in the state and throughout the country, Premera pulled out of the
24 Medicare+Choice program in 2000 due to inadequate federal payment levels. Premera

1 has also shifted away from its HealthPlus HMO product, mainly because of consumer
2 dissatisfaction with HMOs. Finally, Premera reduced its involvement in the Public
3 Employees Benefit Board program in 1998, and left altogether in 2004 due to financial
4 concerns about anticipated losses that would result from the program terms for 2004.

5 Decisions to exit a line of business are difficult, but at times necessary. Creating
6 profitable growth is critical to the financial health and overall success of Premera,
7 regardless of its capital structure.

8 **Q. Would Premera's approach to participation in certain product lines change**
9 **following a conversion?**

10 A. No. Premera's review and decision process for participation in certain product
11 lines will not change as a result of a conversion to for-profit status. Regardless of
12 whether or not Premera is a for-profit plan, it is critical that Premera operate in a
13 financially sound manner in order to ensure that it can meet its commitments.
14 Participating in lines of business that would lose significant amounts of money is not in
15 the best interests of maintaining the financial stability of the Company.

16 **Q. What geographic areas of the state does Premera serve?**

17 A. Premera, through its Blue Cross and LifeWise companies, currently offers
18 products in every county in Washington. Premera Blue Cross offers products in every
19 county except Clark, and LifeWise offers products in every county.

20 **Q. Are there circumstances where Premera would consider pulling out of a**
21 **particular service area?**

22 A. Premera does not have any plans to pull out of any of its current services areas. It
23 would do so only under unusual circumstances. For example like other health plans,
24 Premera left certain counties in the Healthy Options and the Basic Health Plan programs

1 when it was unable to contract an adequate network at a price that would allow the
2 Company to operate those businesses profitably in those areas given the level of state
3 reimbursement.

4 **Competitive Premiums**

5 **Q. In your experience, what do consumers look for when choosing a health
6 plan?**

7 A. Consumers of health care coverage are price sensitive. That is, consumers will
8 place a great deal of importance on even small differences in price when making their
9 buying decisions. In my experience, price plays the predominant role in purchase and
10 renewal decisions in the markets for individual and small group coverage. For larger
11 groups, while price remains important, other factors such as disease management
12 programs, online access to claims information, dedicated customer service teams,
13 customized customer reporting, and strong local and national networks play a larger role
14 in the purchase decision.

15 **Q. What would happen if Premera were to offer a product with premiums
16 priced above its competitors' premiums?**

17 A. Companies and individuals often switch health plans for a small difference in
18 price. If Premera were to offer a product with premiums priced significantly above that
19 of its competition, Premera likely would lose membership in that product.

20 Competition keeps premiums within a fairly narrow range for similar benefits.
21 Consumers are well-informed and assisted in their purchase decision by knowledgeable
22 consultants and agents. There is no line of business or any area of the state in which
23 Premera can charge premium rates that are out of line with its competition and expect to
24 maintain its membership.

1 **Q. Is there any evidence that Premera's customers are price sensitive?**

2 A. Certainly. Consumer price sensitivity is illustrated by the results from a few
3 recent price actions:

- 4 • Starting in 2001, Premera's small group products in the 1-50 line were
5 priced above the market range. From July 2001 through July 2003,
6 Premera's membership dropped by over 32,000 members. During the first
7 six months of 2003 alone, Premera lost over 12,000 members. These
8 membership declines were reversed in July 2003 after the Company
9 launched a new product which was priced within the market range.
10 During the subsequent five months, Premera gained over 2,000 members.
- 11 • Beginning in June 2003, Premera Blue Cross increased premium rates by
12 26% in the Individual line. As a result of the increase, Premera Blue
13 Cross' disenrollment for June and July was nearly three times that of the
14 month prior to the change.
- 15 • In May 2003, LifeWise of Washington instituted an 18% rate increase in
16 its individual product. For the five months following there was an average
17 30% increase in cancellations compared to the number of cancellations
18 during the five-month period prior to the increase.

13 **Q. Would the importance of maintaining competitive premiums change
14 following a conversion?**

14 A. A conversion to for-profit status would not change the importance of maintaining
15 competitive premiums. First, the conversion will not change the competitive dynamics of
16 the marketplace: customers will continue to demand the most competitive prices, brokers
17 will continue to work on behalf of their clients to obtain the best price possible, and
18 competitors will continue to offer products that compete with Premera's.

19 **Market Entry**

20 **Q. How difficult would it be for a health plan to enter Washington and offer a
21 competitive product?**

22 A. If a health plan decides to offer coverage in Washington, the task of starting up
23 operations would not be more difficult in Washington than in any other mature market in
24

1 the United States. While the provision of health coverage is highly regulated,
2 Washington's licensure requirements are not materially different than those found in
3 other states. Once a health plan has met the initial requirements to offer coverage, the
4 most difficult obstacle to offering a competitive product is the establishment of an
5 attractive network. The easiest solution to this is to rent a network, which many
6 competitors, like CIGNA, do. Furthermore, the availability of adequate rental networks
7 makes this a viable option.

8 **Q. Are you familiar with any new plans that have entered the market recently?**

9 A. Recently, there have been a number of health plans that have begun operations in
10 Washington State. PacifiCare is ramping up their business in the state and HealthNet has
11 used Spokane as one of the first markets in the country in which it is offering its Vivius
12 product. In addition to health insurers, PHCO, a physician-sponsored third party
13 administrator, began operations in Eastern Washington in 1995.

14 **Q. How difficult would it be for a health plan with current operations in
Washington to start offering a product in a new line of business?**

15 A. Generally, it would not be difficult for a plan to begin offering a product in a new
16 line of business. First, an existing plan would already have access to a network, which is
17 the most resource intensive hurdle. Furthermore, since sales are predominately broker or
18 consultant driven, distribution channels are already established. For example, Asuris, the
19 Regence non-Blue branded product in eastern Washington, began by offering small group
20 products. Recently, Asuris announced that it is also offering individual products. Aetna,
21 whose primary focus has been on national account and mid-market business, is now
22 entering the small group segment as well.
23
24

1 **Q. How difficult would it be for a health plan with current operations limited to**
2 **one part of the state to expand its products to a new part of the state?**

3 A. Expanding operations to a new area within the state would be relatively easy for a
4 health plan already operating in the state. Since a plan already is licensed and
5 operational, products would already be in place and regulatory requirements would have
6 already been met. The largest hurdle would be to have an adequate network in the new
7 area. As previously mentioned, there are adequate networks available to rent, in place of
8 contracting and servicing a network from scratch.

9 **Premera's Operations Relative to For-Profits**

10 **Q. Given your experience with for-profit and non-profit companies, is there any**
11 **difference between how Premera markets its products in comparison with**
12 **for-profit companies?**

13 A. From a sales and marketing perspective, Premera does not receive any advantage
14 from being a non-profit company when trying to win business. Customers and brokers
15 do not demand any less of non-profit health insurers compared to for-profit ones. As a
16 result, the marketing and sales requirements of non-profit carriers are indistinguishable
17 from those of for-profit companies.

18 As Chief Marketing Officer for the Premera family of companies, I have
19 responsibility for sales and marketing for both its for-profit and non-profit companies.
20 Premera Blue Cross is a non-profit company and Premera's LifeWise subsidiaries in
21 Washington, Oregon and Arizona are for-profit. There is no difference between how we
22 approach marketing and selling Premera Blue Cross business and LifeWise business.

23 **Q. Does this conclude your testimony?**

24 A. Yes, it does.

VERIFICATION

I, HEYWARD DONIGAN, declare under penalty of perjury of the laws of the
State of Washington that the foregoing answers are true and correct.

Dated this ____ day of March, 2004, at Mountlake Terrace, Washington.

/s/
HEYWARD DONIGAN